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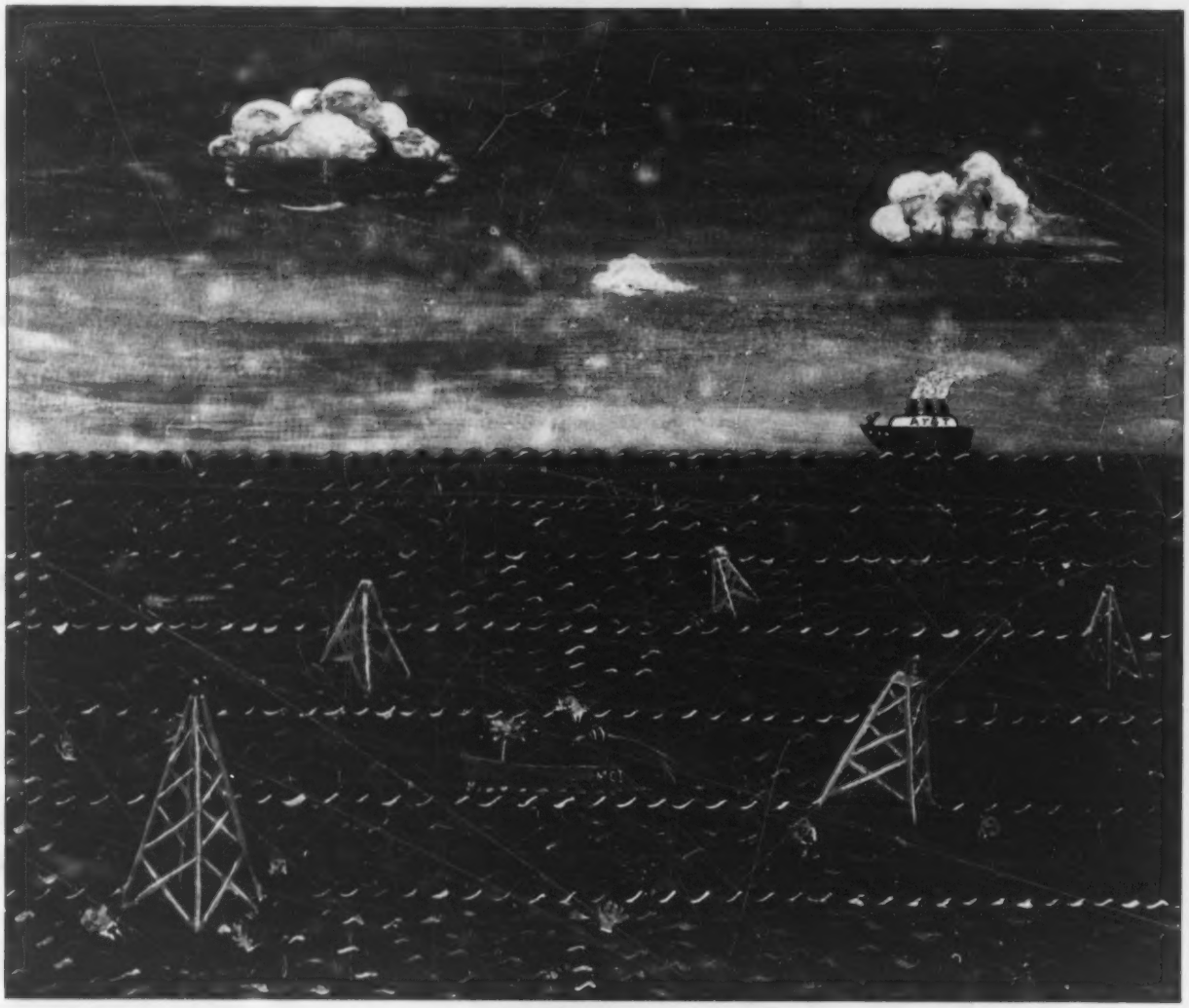

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Strategic Challenges:

Interexchange Carriers Navigate A Treacherous Sea

ELLIS BOOKER, FEATURES EDITOR

SIGHTING trends in the interexchange industry is no easy task. A young and volatile industry, the post-divestiture IXC marketplace has been characterized by punishing price wars, mergers and acquisitions of companies both large and small and a spate of service introductions, ranging from WATS and 800 services to videoconferencing and overseas electronic mail.

If this environment has been tough on industry prognosticators, it has been brutal for the IXCs themselves. Most recently, fierce competition among the industry's three dominant players, AT&T Communications, MCI Communications Corp. and US Sprint Communications Co., made for a bloody 1986, and all three carriers entered 1987 announcing financial losses.

AT&T ended 1986 by cutting 27,400 jobs, closing some facilities and taking a $3.2 billion charge against fourth quarter earnings. MCI cut its own staffing 16%, took a $500 million write-down and did not achieve its anticipated market share. And although US Sprint has not made staff reductions, the carrier recently announced a $199.2 million pre-tax loss in the fourth quarter (TELEPHONY, Feb. 16, page 30).

The Top Three

AT&T, MCI and US Sprint face different strategic challenges in the coming year, according to Berge Ayvazian, director of telecommunications consulting at The Yankee Group, Boston. In particular, he cites their efforts to provide business customers with data network solutions.

"AT&T is going through a major overhaul of their tariffs, while at the same time trying to integrate the sales forces of information services and communications," Ayvazian says. But he notes that the company's efforts to offer enhanced network services and "usher in the next phase of ISDN," have not been as successful as hoped.

MCI also has had trouble offering enhanced network services and migrating former SBS satellite customers onto VNET, its virtual network service, Ayvazian says. The hands down winner in the virtual network services race has been US Sprint, he says. Sprint has claimed 150 customers for its virtual private network offering.

Ayvazian credits US Sprint's inroads into the corporate marketplace to its national accounts organization, which he suggests has done a good job at targeting applications for major accounts. "Like MCI, Sprint has realized that those national accounts will be a long-term source of income," he says.

However, beneath this roiling surface, some industrywide, strategic marketing trends are evident. The most obvious of these, confirmed in conversations with representatives from numerous carriers, is the shift away from a "price-only" sales strategy. Second, a number of companies, particularly those in the "second tier," are honing their sales organizations, finding ways to target potential customers and markets more precisely (Figure 2).

Analysts also agree that while AT&T, MCI and US Sprint play a game of follow-the-leader with price cuts and service introductions, the most interesting activity in the IXC marketplace is to be found among the second tier companies. For it is here, among these predominantly business-oriented carriers that the true battle for market share is being waged.

Features and Service

Without question, price differences between carriers continue to shrink. Asked to describe the price advantage between his newly announced WATS product and those of competitors, a Western Union official said, "it's equal to, it's just below . . . it's the skin of an onion."

Over the entire spectrum of IXCs, in fact, price advantage is being set in the context of network quality and ancillary services. "Over the last 12 to 18 months we have moved to a 'value position,'" reports William Maloney, vice president, sales and marketing at ALC Corp. Value, Maloney continues, is "an indistinguishable combination of price, service and quality."

With 1986 revenues of $500 million, ALC ranks a distant fourth in revenues behind AT&T, MCI and US Sprint (Figure 1). According to Maloney, the company has approximately 500,000 customers, about one-third of whom are commercial subscribers. Almost exclusively a voice carrier, Maloney says the com-

pany does not actively seek data customers.

While Maloney confirms that ALC will test both 800 NXX and operator assistance services later this year, as well as expand its international connections to 20 or 30 countries, he says the company is concentrating attention on improving its core business. And like several other IXCs, ALC is focusing on a mundane but critical aspect of its business: customer billing.

"We provide either paper or magnetic tapes with customized bills, as well as detailed account summaries," says Maloney, who adds that customers on dedicated facilities also receive post-sale support in the form of local customer support representatives who review bills, handle service problems and help customers reconfigure their networks when necessary.

About 100 people compose the sales force at ALC. These are split between a telemarketing group for residential and a field sales force for larger customers and dedicated line services.

Asked why ALC pursues the residential market, when fully two-thirds of its revenues come from the commercial side, Maloney explains that this is necessary to optimize the network during off-peak hours. But he adds that the company plans its expansion carefully, so as not to be overwhelmed with numerous, low-volume customers. "If we see that a particular spur off a backbone is not completely used, we can blitz that area with telemarketing," he says.

Pure Business

Shunning residential customers completely, fifth ranked Cable & Wireless Communications Inc.'s long-distance arm, TDX Systems Inc., is targeted at business customers. A subsidiary

Continued on page 35

Tracking the Second Tier

CZATDANA INAN, MARKET RESEARCH DIRECTOR

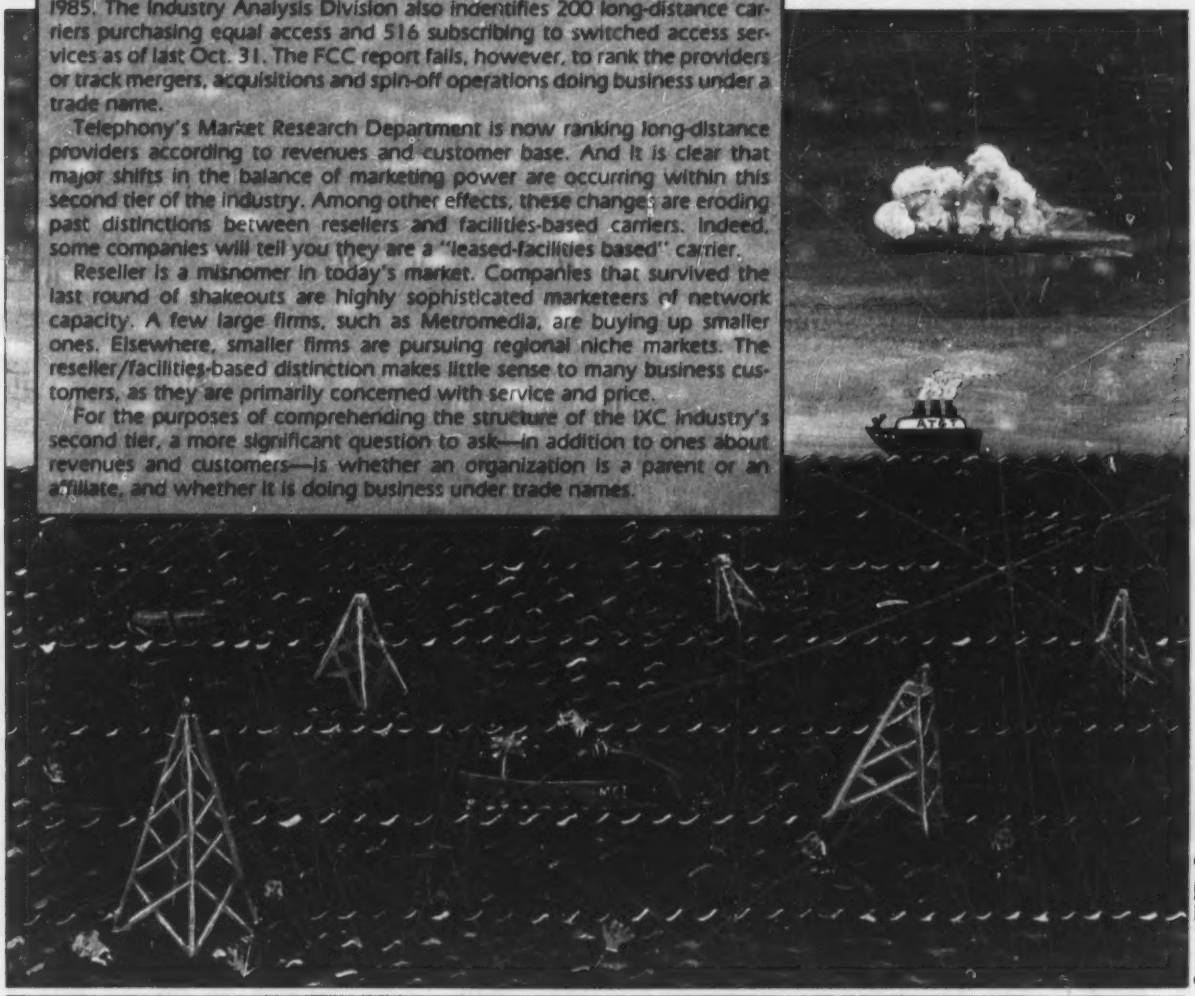
THE LONG-distance marketplace below the top few companies is a puzzle. Conventional wisdom has resellers floundering in the waves while AT&T, MCI, US Sprint and one or two others keep above water and hope for calm seas. Together, these top carriers account for 90% of the market.

Yet the Industry Analysis Division of the Federal Communication Commission reports there were 348 "entries" with Feature Group A or Feature Group B carrier identification access codes as of this January, up from 217 in 1985. The Industry Analysis Division also indentifies 200 long-distance carriers purchasing equal access and 516 subscribing to switched access services as of last Oct. 31. The FCC report fails, however, to rank the providers or track mergers, acquisitions and spin-off operations doing business under a trade name.

Telephony's Market Research Department is now ranking long-distance providers according to revenues and customer base. And it is clear that major shifts in the balance of marketing power are occurring within this second tier of the industry. Among other effects, these changes are eroding past distinctions between resellers and facilities-based carriers. Indeed, some companies will tell you they are a "leased-facilities based" carrier.

Reseller is a misnomer in today's market. Companies that survived the last round of shakeouts are highly sophisticated marketeers of network capacity. A few large firms, such as Metromedia, are buying up smaller ones. Elsewhere, smaller firms are pursuing regional niche markets. The reseller/facilities-based distinction makes little sense to many business customers, as they are primarily concerned with service and price.

For the purposes of comprehending the structure of the IXC industry's second tier, a more significant question to ask—in addition to ones about revenues and customers—is whether an organization is a parent or an affiliate, and whether it is doing business under trade names.



Cover art by Mike Zimmerman

of Cable & Wireless North America Inc., which in turn is a subsidiary of Cable & Wireless plc, London, the IXC reported $165 million in 1986 revenues for the year ended March 31, and claims 50,000 business customers.

Regarding marketing efforts, Oberlin says that direct sales—there are 180 people for the company's 20 markets—have been the most powerful tool.

In contrast to ALC's experience, telemarketing did not work for this business carrier. "We went into telemarketing and dropped it," Oberlin says, observing that a telemarketing approach is probably best suited for consumer products sold on a price-only basis. Likewise, the company has not used many direct mail campaigns, says Oberlin, because it believes these work best with a telemarketing thrust.

Oberlin also reports that the company is now more actively pursuing reseller contacts. "Even small resellers are in a position to stay around. The telecommunications professionals will stay around," he says.

Patrick Fiske, director of public relations at American Network Inc., agrees. "We think in the long run, long distance will become more and more a commodity service," he says, adding that sales and support become the critical element for success in such an environment. Fiske says the company has targeted the $5000 to $10,000 a month business customer.

One of the largest resellers, American Network has been on a buying binge of smaller companies over the past two years. Among its main acquisitions last year were two California-based companies, Startnet and ATE. Currently, American Network claims some 80,000 customers, two-thirds of whom are business subscribers, and adjusted 1986 revenues of $174 million. Its sales organization includes 15 offices in major cities, and the company announced last month a 10-year lease of a Williams Telecommunications Co. facility.

According to Fiske, who says the carrier is targeting nationwide rather than regional service, the company believes it occupies the number six slot in the industry's revenue table.

Even quite small, regional resellers believe they have a place in the market. Gib Carpenter with TMC of Arkansas compares the relationship between reseller and facilities-based carrier with that of the airlines and travel agents. "Resellers are in an enviable position, they're not tied to huge capital investments," says Carpenter, who says his 1 million minute per month company is the second

Continued on page 56

FIGURE 1 TOP CARRIERS' 1986 NET REVENUES

Source: Telephony/Market Research
*estimated by Telephony
a: includes US Sprint last six month revenues of $1,141.1 million, first six month US Telecom revenues of $212.4 million and estimated comparable first six month revenues for GTE Sprint of $661.5 million.
b: as of 9/30/85
c: National Telecommunications Network consortium
d: estimated fiscal 3/31/87
e: 250,000 total customers
f: current annualized revenue is $174 million, due to aquisition of Startnet (9/86) and ATE (11/86)
g: estimated on revenues of $44.7 million as of 9/30/86
h: not available

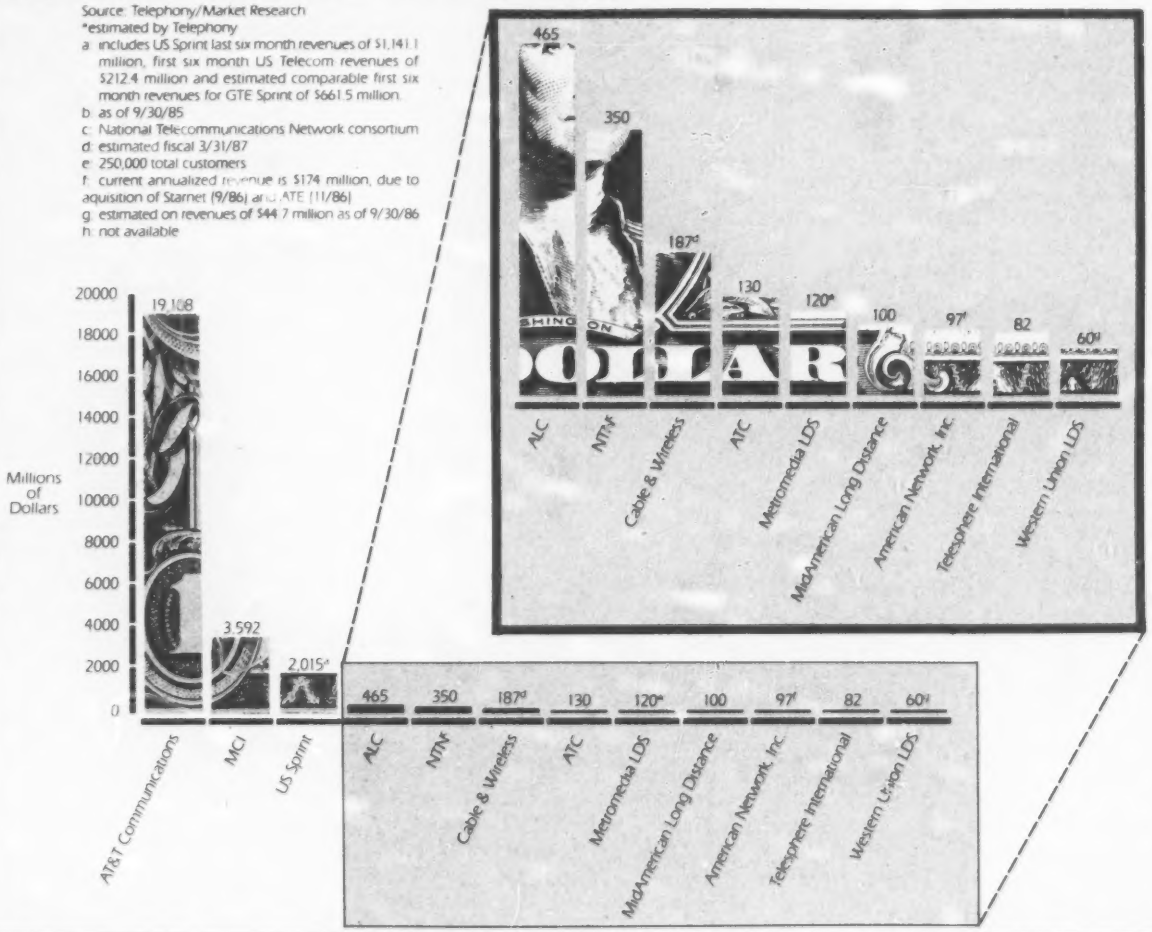
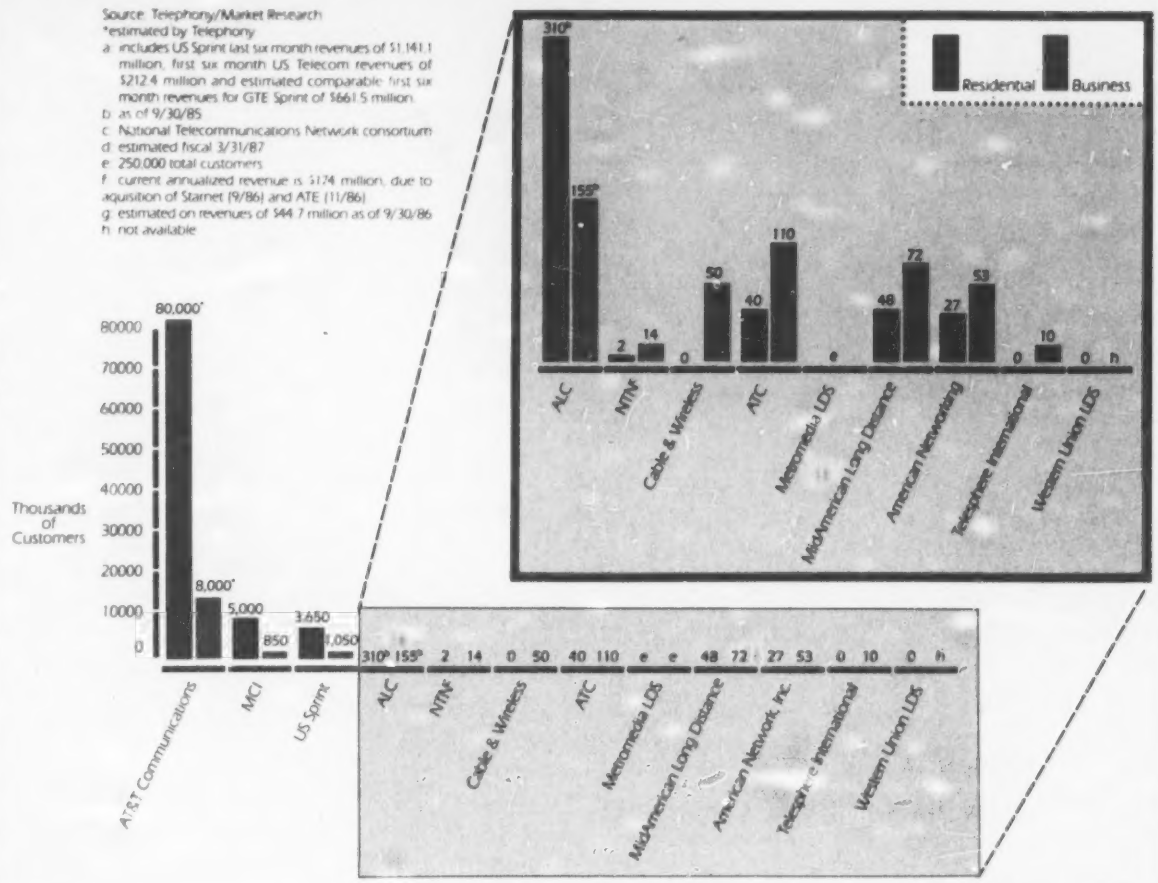


FIGURE 2 1986 BUSINESS/RESIDENTIAL CUSTOMER BASE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g: estimated on revenues of $44.7 million as of 9/30/86
h: not available
Residential
Business
Thousands of Customers
80,000*
8,000*
5,000
850
3,650
1,050
310* 155* 2 14 0 50 40 110 e e 48 72 27 53 0 10 0 h
AT&T Communications
MCI
US Sprint
ALC
NTN*
Cable & Wireless
ATC
Metromedia LDS
MidAmerican Long Distance
American Network, Inc.
Telesphere International
Western Union LDS

IXCs

Continued from page 35

largest alternative carrier in Arkansas behind AT&T.

This analogy is only partly accurate, of course.

Resellers can pick and choose from among the carriers, but they are not commissioned agents of those companies. At least, not yet. It is provocative to imagine whether such sales agency joint ventures will appear sometime in the near future.

Carriers' Carriers

Finally, there are the regional FO carriers, sometimes called the carriers' carriers.

"I see the fiber carriers as wholesalers," says The Yankee Group's Ayvazian. "What these guys are doing is forming operating agreements with the second tier [companies], who in turn act as resellers."

But regionals such as LDX Net Inc., which recently created a national sales force, seem intent on pursuing a resale strategy as well. Indeed, a reflection of the battles brewing in the second tier is the fact that LDX Net's sales team is reportedly invading the territories of the other six companies in the National Telecommunications Network, the two-year-old consortium of regional fiber carriers to which it belongs.

Regulatory Matters

While the IXCs learn how to carve out their markets, debate has begun in earnest about having seven new players enter the game; namely, the Bell regional holding companies.

According to ALC Vice President and General Counsel James Tobin, the most pressing regulatory event for carriers is the proposal, made last month by the Department of Justice, to allow the Bell regional holding companies to offer interLATA services outside their franchise territories.

"It's the camel's nose under the tent," says Tobin, who was recently elected vice chairman of CompTel, a Washington-based association of about 200 IXCs.

"Either we'll see a host of BOC to BOC interLATA agreements, or a request from the BOCs in a year's time to do away with the extraterritorial restraint because it's impractical," he says. Tobin believes the second scenario is more likely.

Whether or not the RHCs enter, however, the marketing realities will likely remain the same. Price differences will drop, and consumers will increasingly look to their IXCs for value-added services. As TDX Systems' Oberlin puts it: "You have to be more than a price per minute from Chicago to Washington. You need an overall package." □